



# FARM Assistance

*Focus*



## Impacts of the Texas Tax Reform Commission Tax Policy Provisions on Farms and Ranches in Texas

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**Scenario A:**

**Assuming the 196 farms are sole proprietors and thus exempt from the margins tax, the average impact of the proposal would be a savings of \$637 per operation annually.**

In an ongoing effort to reconcile the funding of Texas' public school system as well as to provide meaningful property tax reductions, the Texas Tax Reform Commission (a 24 member group of state business leaders) was formed by Governor Rick Perry and former Texas comptroller John Sharp. The Commission has proposed a reduction of property taxes that would be offset by a revised version of the franchise tax, a motor vehicle sales and use tax, and a \$1 per pack increase in the cigarette tax. The development of the proposed legislation has raised the question of the potential impacts any shift in the tax burden may have on agricultural producers. This paper estimates the impact of the margin tax and property tax reduction provisions on Texas farmers and ranchers. Specifically, the analysis focuses on the farm and ranch participants in Texas Cooperative Extension's Financial and Risk Management (FARM) Assistance program.

FARM Assistance is a financial planning model used to help producers evaluate alternative management strategies. Data collected and used in individual analyses has led to an extensive database of individual producer data reflecting the program's clientele in Texas. From this database, 196 operations that recently completed the FARM Assistance program were selected for analysis. Impacts are also estimated for subgroups of producers based on type of production. The producer types consist of crop farms, livestock

ranches, and diversified operations defined as follows:

- **Crop Farm:** An operation whose crop enterprise(s) accounts for 75% or more of total receipts
- **Livestock Ranch:** An operation whose livestock enterprise(s) accounts for 75% or more of total receipts
- **Diversified:** An operation that does not meet the criteria for classification as a Crop Farm or Livestock Ranch

Average impacts are also reported by crop enterprise. The 147 crop and diversified operations were further categorized as corn, cotton, grain sorghum, and wheat producers. An operation is classified as a corn producer if corn makes up at least 15% of the planted acres, and similarly for the three other commodities. Several farms fall into more than one category.

**Property Taxes Changes**

Property tax savings result from provisions reducing the maximum school tax rate from \$1.50 to \$1.00 per one hundred dollar valuation. Actual savings could be less than \$0.50 for districts not currently at the maximum \$1.50 tax rate. This study assumes a \$0.46 savings on a total property tax bill of \$2.30 per one hundred dollar valuation (including county, city, school M&O, and school I&S). The result is a 20% savings to the current total property tax bill. The analysis does not include any change in rental arrangements, lease rates, or land values that may result from lower property taxes.

**Proposed Margins Tax**

The analysis assumes that none of the 196 operations currently pay the existing franchise tax. The revised business/franchise tax has been termed a margins tax, assessing a 1% fee on annual taxable margin for most businesses, and 0.5% for certain retail and wholesale businesses. This margin is calculated as the total revenue less either compensation expenses or the cost of goods sold. Allowable compensation expenses can include both cash compensation and the cost of employee benefits. Cost of goods sold includes all direct and indirect expenses related to producing a good. Interest and financing expenses as well as income and franchise taxes are not deductible.

For the purpose of calculating the potential tax for the FARM Assistance operations, the analysis assumes that each operation would choose the cost of goods sold option. The analysis uses Net Farm Income (NFI) as a starting point to approximate taxable margin. NFI is a "before income tax" profit measure that includes all business revenue less farm business expenses. The farm business expenses included in NFI closely match the list of allowable expenses in the definition of cost of goods sold, with the exception of interest expenses. The analysis also assumes that local property taxes are a deductible expense. As property taxes are included in NFI, any reduction in property taxes would result in an increase to NFI. Therefore, taxable margin is estimated by adding interest



**Scenario B:**

**Net of the property tax savings the proposal would result in an increased annual tax burden of \$124 per operation, assuming all producers are subject to the margins tax.**

expense and the estimated property tax savings to NFI (Table 1).

**Exemptions**

Sole proprietors and general partnerships are exempt from the proposed margins tax. Additionally, under the current proposal, operations with less than \$300,000 in total revenue would also be exempt.

Most FARM Assistance participants are structured as sole proprietors or general partnerships, and would therefore be exempt from the new margins tax. While the data on average suggests that 100 of the 196 operations would be exempt for

having less than \$300,000 in total revenue, these farms could exceed the \$300,000 level in high yield or price years. Similarly, an operation that typically earns over \$300,000 in revenue could become exempt in low yield or low price years.

For these reasons, the analysis estimates the impacts of the proposal under two scenarios that represent the opposite extremes regarding exemption from the margins tax.

Scenario A assumes that all farms and ranches in the database are either sole proprietors or general partnerships and would not pay the

new margins tax. This assumption holds for a majority of the FARM Assistance database clients, making this scenario the most realistic.

Scenario B assumes that all farms and ranches are subject to the margins tax regardless of average revenue level or entity structure. As described previously, most FARM Assistance clients are sole proprietors and roughly half have less than \$300,000 in revenue, making this scenario extreme and less realistic. It is included here to illustrate the relative impact of the proposed margin tax vs. the property tax reduction. It also serves to quantify the value

**Table 1. Average Impacts of Texas Tax Reform Commission Proposal**

	All Farms & Ranches	Crop Farms	Livestock Operations	Diversified Operations	Corn	Cotton	Sorghum	Wheat
Number of Operations	196	127	49	20	25	86	44	52
<b>Scenario A: assuming all operations are sole proprietors and exempt from the margin tax</b>								
Current Property Tax	\$3,186	\$3,577	\$1,831	\$4,023	\$4,200	\$2,940	\$3,638	\$4,641
Property Tax Savings (20%)	\$637	\$715	\$366	\$805	\$840	\$588	\$728	\$928
<b>Average Net Savings</b>	<b>\$637</b>	<b>\$715</b>	<b>\$366</b>	<b>\$805</b>	<b>\$840</b>	<b>\$588</b>	<b>\$728</b>	<b>\$928</b>
<b>Scenario B: assuming all operations are subject to margin tax</b>								
Average Annual Net Farm Income	\$47,662	\$58,801	\$23,589	\$35,911	\$87,468	\$59,967	\$77,102	\$64,973
Average Annual Interest Expense	\$27,781	\$31,150	\$15,519	\$36,430	\$44,319	\$32,048	\$36,926	\$40,343
Property Tax Savings (20%)	\$637	\$715	\$366	\$805	\$840	\$588	\$728	\$928
Average Annual Taxable Margin	\$76,080	\$90,666	\$39,474	\$73,145	\$132,627	\$92,603	\$114,756	\$106,244
Proposed Margin Tax (1%)	\$761	\$907	\$395	\$731	\$1,326	\$926	\$1,148	\$1,062
Less Property Tax Savings	\$637	\$715	\$366	\$805	\$840	\$588	\$728	\$928
<b>Average Net Tax Increase</b>	<b>\$124</b>	<b>\$191</b>	<b>\$28</b>	<b>(\$73)</b>	<b>\$486</b>	<b>\$338</b>	<b>\$420</b>	<b>\$134</b>
Number realizing a net tax increase	121	87	25	9	18	63	33	32
Number realizing a net tax savings	75	40	24	11	7	23	11	20

of the exemption from the tax by comparing the results to the more realistic scenario A.

**Impacts: Scenario A**

Assuming the 196 farms are sole proprietors and thus exempt from the margins tax, the average impact of the proposal would be a savings of \$637 per operation annually. The most significant savings occur for crop and diversified operations with a savings of \$715 and \$805 respectively. Livestock operations tend to pay property taxes on a lower agricultural use value and would see smaller savings of \$366 on average. Further, when broken down by crop type, wheat farms will see the greatest net savings at \$928 per farm. Corn and sorghum follow closely behind at \$840 and \$728, respectively. The cotton producers have the lowest average current property tax bill, and therefore, would realize the smallest savings (\$588) of the commodity type categories.

**Impacts: Scenario B**

The calculation of average annual taxable margin is provided in Table 1. Interest expenses and the estimated property tax savings are added to the net farm income to produce the annual taxable margin. Impacts for individual operations vary beyond the averages reported in Table 1, but if all 196 farms were subject to the tax, on average the annual margin tax due would be \$761. Net of the property tax savings the proposal would result in an increased annual tax burden of \$124 per operation, assuming all producers are subject to the margins tax. The number of farms realizing a net tax increase in this case would be 121 or 62% of the farms in the database.

Crop Farms would incur the greatest increase in their tax bills with an anticipated increase of \$191. The more specific commodity classifications, with exception of wheat, would realize even higher net tax increases

assuming each farm was indeed subject to the margin tax. Livestock operations would incur an average of \$28 additional tax, while the average diversified operation would see an annual net savings of \$73.

Again the results presented in Scenario B reflect the extreme assumption that all operations are subject to the proposed margin tax.

**Summary**

In conclusion, the moderate sized commercial agricultural producer is likely to experience a net savings from the proposed tax provisions, as most would be exempted as sole proprietors or general partnerships from the margin tax. The two extreme scenarios presented here represent the upper and lower bounds of the anticipated average impact. The actual average impact to a broader pool of agricultural producers is expected to be between the two scenarios, and should fall much closer to the net savings illustrated in Scenario A.

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